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Social and Economic Convergence of the Western Balkans in the time of Crisis

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Marta Szpala

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Author: Marta Szpala

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Introduction

In recent years, the social-economic convergence between the countries of the Western Balkan region and the EU has gained growing attention: many scholars and politicians have pointed out that the bleak economic outlook of the region is one of the greatest obstacles for its stabilization and development (Bonomi, 2018) and that slow progress in achieving social convergence is an important factor contributing to the deferred progress in their EU integration (European Economic and Social Committee, 2018). This interest is also related to the fact that the economic crisis in 2008 undermined democratization process in the Western Balkans as it led to strengthening governing parties' grip on the state and media and the rule of law through informal power-structures (Kmezić & Bieber, 2017).

Having the importance of social and economic convergence in mind, the aim of the Berlin Process i.e., launched in 2014, was to support economic growth in the region by promoting regional economic cooperation among the Western Balkan countries and infrastructure connectivity. Similarly, economic and social cohesion of the Western Balkans was one of the Bulgarian Presidency's priorities in 2018. Over the past years, the region has slowly recovered and the economic situation has improved. The Western Balkans countries have enjoyed relatively robust GDP growth peaking in 2018, when it hit 3,9%. Economic growth led to job creation, making unemployment rates decline to historically low levels. Despite that, the convergence of the region with the EU average is relatively slow, the structural weakness of local economies remains and the Western Balkan growth model – based on consumption – has been vulnerable already before the Covid19 crisis (World Bank Group, 2020a). The outbreak of this global pandemic suddenly interrupted the fragile growth momentum. Expectedly, the consequences of the Covid19 crisis for the Balkans economies will be severe. If left without significant financial support the socioeconomic situation in the region will deteriorate quickly. In consequence, not only living standards will worsen as unemployment rates rise again, but even more dramatically, this economic shock will be followed by further democratic backsliding.

During the Coronavirus pandemic the shared fate of the Western Balkans and the EU has become even more apparent which is why this moment should be seized as opportunity to overcome the consequence of the current hardship together, speed up the reform process and fully integrate the region with the EU.

Common Challenges for social and economic convergence

The Western Balkan countries are highly integrated with the EU in economic terms. The EU is the main trading partner of the whole region. 72% of the Western Balkans' export is going to EU member states and 58% import is coming from there. The EU, through companies from member states, also holds a dominant position in foreign direct investment accounting to 70% of FDI inflows towards the region. EU companies are important players in profitable sectors like banking (from 75% to 95% of local banks are foreign owned, mainly by banks from the EU), telecommunication, real estate or retail trade. The Western Balkans are also included into some sectoral policies of the UE via Transport and Energy Community.

The second socioeconomic problem in the region is the massive outward migration to the EU. In 2018 alone, 230 thousand citizens from the Western Balkans obtained their first permits of residence within the EU (Töglhofer, 2019). This is not only draining the region of its human capital, but also means that EU countries are taking advantages of skilled workers educated on the expense of poorer countries in the neighbourhood. Hence, despite investment in their education systems, the Balkan countries are faced with a critical lack of educated workforce and human resources; one of the key preconditions to achieve convergence (Obućina, 2020).

Thirdly, although the economic and institutional integration of the Western Balkans with the EU has increased, this was accompanied by backsliding of democratic standards. Many structural problems of local economies remain unaddressed, leaving the region with very limited growth potential. Export capacities are weak and based on the production of products with low value. The lack of good infrastructure decreases the investment attractiveness of the region. Progress in the implementation of connectivity projects has been slow and in terms of digital infrastructure the countries in the region are severely lagging behind EU countries (Zogjani & Gashi, 2019).

Although it has been changing slowly in past years, the social converges between the Western Balkans and the EU has never been a priority in the EU policy towards the region (Jusić, 2020). Despite some improvements, the Balkan countries still face high unemployment rates, especially among the young population. The level of minimum wages is very low which stimulates migration and exacerbates challenges of ageing populations. The rate of (or being at risk of) poverty is much higher than in the EU (from 27% in BiH to 22,2% in North Macedonia, while EU – 28 average is 16,9%). At the same time the rates of income inequality are growing all over the region. The overall standard of living is lower than the EU average especially considering the poor access to and quality of social and health systems. The lack of visible social change associated with the progress of EU integration is one of the reasons for decreasing support for membership in the EU.

Additionally, the current structure of linkages between EU core countries and the Western Balkans work in the interest of the former at the expense of the latter (Bonomi et al., 2020). A vast amount of financial resources is transferred either through repayment of debts or through trade from the Western Balkans to EU core countries like Germany, Italy and Austria – the region's main trading partners and investors (Bonomi, 2018). Huge trade and current account deficits are damaging the macro-economic performance and development potential of the Western Balkans latter (Bonomi et al., 2020). Similar trade and investment relations were observed in Central European countries, where however economic imbalances were compensated by an influx of structural and other funds. This is not the case in the Western Balkans where the financial support available for the Western Balkans under the instrument for pre-accession (IPA II) is significantly lower than funds are for EU member states. From 2014 through 2020 all six Western Balkans countries have received €3,9 billion together, while Croatia alone had access to 10.7 billion euro (Töglhofer, 2019). Already before the pandemic Western Balkan countries were predicted to take several decades to converge with the average EU GDP per capita. The current crisis has most likely prolonged that time frame even further.

The impact of the global pandemic

Due to quick reaction of local governments which introduced very restrictive measures of social distancing in the early stage of the pandemic the number of coronavirus cases in the Western Balkans has been much lower than in Western Europe. Despite the fact that local authorities managed the health crisis initially relatively well, the economic consequences for the region will be profound due to restrictions in economic life and an expected recession in the EU. The governments across the region introduced fiscal packages to mitigate the impact of the crisis on the local economies but due to limited fiscal manoeuvring space these are significantly smaller than those of EU members. Hence, the local economies are more exposed to the economic consequences of this crisis. Currently the World Bank expects the decline of GDP in the region to be up to 5.7% (World Bank Group, 2020b).

First of all, economies of many countries in the region are strongly dependent on tourism (especially Albania and Montenegro) and their economies are closely connected with some of the most affected UE countries (as is the case for Albania and Italy). Countries like Serbia and North Macedonia with a developed manufacturing sector will be hit with disruptions in global value chains and with declining export due to lower demand in the EU. Moreover, a fall in remittances, which account for over 15% of GDP in Kosovo and around 10% in BiH, Albania, Montenegro and Serbia, is expected (World Bank Group, 2020c). Prolonged border closures mean that many seasonal workers, who during the summer work in EU member states, will be left without an income this year. The high level of employment within areas of informal economy in the region means that many people will not have access to help from the state. The deep downturn will cause increased unemployment, collapse of many businesses and decrease in salaries which will ultimately have a very negative impact on public finances. Due to high levels of public debts (local) governments have limited ability to introduce generous fiscal measures to boost the economy.

The Way Ahead

The Covid19 crisis leaves EU Member States and Western Balkans faced with similar challenges and their economic and social fates are interconnected on different levels. The coordinated response to these challenges will not only strengthen the notion of solidarity and external credibility of the EU, but prevent the countries in the Western Balkans to fall into instability triggered by economic hardship. If the EU is really willing to become geopolitically and strategically more autonomous it should not only actively engage to mitigate the economic consequences of the current crisis. More than that, it should use the crisis as an opportunity to trigger a process of deep structural change of their economic relations with and within the region.

To compare: when the financial crisis hit in 2008, the Western Balkans had been mostly left alone with their economic hardship, leading to prolonged stagnation, persistent high unemployment, and slowdown in the reform process. According to some scholars this opened the way for right-wing populists to gain power (Reljić, 2020) and enabled deterioration in the Western Balkans' performance in terms of democratic consolidation (Bechev, 2012). Moreover, the bleak economic situation strengthened the influence of countries like China and Russia in the region, consequently undermining the Euro-Atlantic geopolitical orientation of some countries. Today, it appears though as if the EU has learnt the lessons and has understood their strategic interest in the region.

Aware of their shared fate EU leaders reconfirmed the support for the Western Balkans in tackling COVID-19 and the post-pandemic recovery during the Zagreb EU – WB summit. The recovery package includes not only the immediate support for the health sector, but also significant support for the social and economic recovery through a €750 million package of Macro-Financial Assistance and a €1.7 billion package of assistance from the European Investment Bank (European Council, 2020). Moreover, the European Commission pledged to present a robust economic and investment plan in autumn to boost the economic growth in the region. If the promise will be kept, the region will have a chance for quicker recovery and mitigation of social consequences of the crisis. But it is important to underline that the planned aid is mainly based on loans, not grants. Therefore, the local governments will indeed have instruments to cope with the current economic downturn, but taking into account current levels of public debt there will not remain significant resources to finance solid grounds for future growth. Countries will be keeping burdened budgets in the following years. That means a further limitation of financing capacities for already weakened state institutions, healthcare systems and education. This will lead to further deterioration of social conditions.

This is why, the inclusion of the Western Balkans into an EU recovery plan is extremely important, including the opening of EU structural funds for the countries in the region and a provision of special grants in the framework of economic and investment plans. Access to all these programmes should be granted only if economic reforms are implemented, institutional capacity strengthened and regional cooperation deepened.

Ideally, this crisis can become a chance to take advantage of the economic complementarity between the EU and the Western Balkans and to strengthen the economic cooperation for mutual benefit. Due to security concerns, the USA had pushed to decouple supply chains binding the West to China already before the pandemic. Since the crisis has exposed the risks associated with the outsourcing of the production of strategic goods, now also many in the EU call for stronger Europe sovereignty in strategic value chains and decreased dependency on powers like China in the supply of certain products (Salamé & Demorand, 2020). Others predict that regions will turn inward or towards their nearest neighbors in the post-pandemic world to shorten value chains (Tocci, 2020). The Western Balkans with low labour costs, skilled workers and an industrial tradition are the perfect partner for European companies to conduct this relocation process, especially in sectors such as the automotive industry or pharmaceutics. This could go hand in hand with creating pressure for implementing reforms in the region, enhancing regional cooperation and facilitating mutual trade by adjustments in the regulation and realisation of infrastructure projects. With, on top of that, civil society, (small) business and trade unions included to shape and monitor the implementation of the recovery plan, the aftermath of the Covid19 crisis could be a chance for real change in the EU and the region. Seizing this opportunity would not only speed up the socio – economic convergence between the region and the EU but would also contribute to building up resilience of the entire Europe for the turbulent times ahead of us.

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Outlook: Hard Times Require Good Economics;”

About this contribution

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This contribution builds upon the panel discussions of the 2020 Think Tank Forum Western Balkans Skopje 'Stimulating strategic autonomy - Western Balkans' contribution for a shared European future', organized within the 2020 joint Presidency of the Republic of North Macedonia and Republic of Bulgaria with the Western Balkans Summit Series.

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Contact information about IDSCS

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Address: Str. Miroslav Krlezha 52/2,
1000 Skopje
Phone number: +389 2 3094 760
E-Mail: contact@idscs.org.mk

Information about the author

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Marta Szpala is Senior Fellow at the Department for Central Europe and the Balkans in the Centre for Eastern (OSW) Studies. She specializes in the EU and NATO Integration of the Western Balkans and the social and political transformation of the Balkan States. She provides expertise for various Polish and international administration bodies. She is a guest lecturer at the University of Warsaw, the Diplomatic Academy and the College of Europe in Natolin. She coordinated cooperation of Think Tanks and Civil Society in the framework of Polish Presidency in Berlin Process (2019 -2020).

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